



Memorandum # 47/2006

Commonwealth of Massachusetts | Public Employee Retirement Administration Commission
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Joseph E. Connarton, *Executive Director*

MEMORANDUM

TO: All Retirement Boards

FROM: Dana K. Mahoney, Compliance Officer

RE: PERAC Regulations 840 CMR 16.05

DATE: December 7, 2006

PERAC has recently become aware of an increase in instances of directed brokerage.¹ Therefore, PERAC would like to remind all of the retirement systems that directed brokerage is a violation of 840 CMR 16.05.

PERAC is requesting that all retirement systems review their Disclosure Statements and all files regarding brokerage and provide PERAC with a copy of any and all letters, e-mails or other form of communication directing managers to use certain brokers. PERAC requests that all responses be received by January 8, 2007.

PERAC Regulation 840 CMR 16.05 concerning the use of brokers states:

Use of Brokers

- (1) Retirement system board members and employees shall not:
 - (a) direct brokerage commissions for services, or
 - (b) instruct its qualified investment manager or managers to direct brokerage commissions.
- (2) Selection of brokers shall be based on competitive criteria including best price and execution.

¹ Two former pension trustees, with ties to brokerage firms, voted in favor of awarding contract to Shawmut Investment Advisors. Shawmut placed both of the brokerage firms on its trading list allowing for soft-dollar commissions. (*Investment marketer no stranger to scrutiny*, Toledo Blade, Friday, June 23, 2006.); American Funds was fined \$5 million for paying incentives to brokerages to push the company's mutual funds. (*American Funds Hit by Fine, Censure*, latimes.com, August 31, 2006.) Jefferies & Co., Inc. settled with the SEC regarding it had lavished \$2M of gifts upon traders at Fidelity. (*Jefferies Ordered to Pay Feds \$10M Over Fidelity Flap*, Boston Herald, December 5, 2006)

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- (3) Commission rates shall be negotiated.
- (4) Board members shall review on an on-going basis all brokerage costs.
- (5) Board members shall review on an on-going basis the selection of brokers and use of "soft dollars" (arrangements under which products or services other than execution of securities transactions are obtained from or through a broker in exchange for the direction of brokerage transactions to the broker) by its qualified investment manager or managers.
- (6) Board members shall require the qualified investment manager or managers or brokers to disclose in writing to the board all commissions charged on all transactions and investments made.
- (7) Board members shall require the qualified investment manager or managers or brokers to disclose in writing to the board mark-ups and mark-downs on all trades where the broker acted as dealer/principal.
- (8) Notwithstanding the provisions of 840 CMR 16.00 boards may participate in so-called "commission recapture" programs provided that such participation is consistent with the board's fiduciary duty and other provisions of 840 CMR.

PERAC is committed to working with the Massachusetts retirement systems in an effort to protect the retirement funds. We must all continue to work together to ensure that the public employees' retirement funds are protected from scandalous behavior.

Thank you for your prompt attention to this matter.